

Internal Revenue Service

Department of the Treasury
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Person To Contact:

, ID No.

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CC:FIP:B02

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Date:

December 13, 2007

Legend:

Taxpayer =

Date 1 =

Corporation =

Property A =

Property B =

Property C =

Property D =

Property E =

Year 1 =

Year 2 =

Year 3 =

LP =

Date 2 =

Firm =

a =b =c =d =e =f =g =h =

Dear :

This is in reply to a letter dated March 12, 2007, and subsequent information, requesting certain rulings on behalf of Taxpayer. Specifically, you have requested a ruling that “real estate intangibles”, as described below, will be treated as real estate assets and interests in real property for purposes of section 856(c)(5)(B) of the Internal Revenue Code commencing with Taxpayer’s Year 3 tax year. You have also requested a ruling that any rent payments attributable to the lease of the “real estate intangibles” will be treated as “rents from real property” under section 856(d).

Facts:

Taxpayer is a domestic corporation that was formed in Year 1 and elected to be taxed as a real estate investment trust (REIT) under subchapter M of the Code for its Year 2 tax year. Taxpayer owns, through wholly-owned subsidiaries, all of the outstanding interests in LP. Taxpayer owns substantially all of its operating assets, either directly or indirectly, through various entities including wholly-owned or majority-owned subsidiaries, partnerships, joint ventures, taxable REIT subsidiaries (TRSs), and a subsidiary REIT.

On Date 2, Taxpayer acquired the stock of a corporation that then became a qualified REIT subsidiary of Taxpayer. As part of the stock acquisition, Taxpayer acquired Property A, Property B, Property C, Property D, and Property E (the “Properties”). On or about Date 2, Taxpayer retained Firm to determine the appropriate purchase price allocation for Generally Accepted Accounting Principles (“GAAP”) purposes, including the identification and fair valuation of the tangible and intangible assets for each of the Properties.

On Date 1, Taxpayer agreed to be acquired by Corporation for cash in exchange for all of Taxpayer’s common stock and the assumption of Taxpayer’s outstanding debt. Among the portfolio of properties that were acquired by Corporation are the Properties, each of which is a widely-known resort hotel with a significant reputation as a travel destination.

The purchase price allocation report prepared by Firm valued the Properties at a dollars. Of that amount, b dollars was allocated to the total identifiable intangible assets, which included c dollars attributable to trade names and brand names (the names under which the resorts operate). Additionally, d dollars were allocated to goodwill. The trade names or brand names together with the goodwill component of the total value comprise the “real estate intangibles”.

The purchase price allocation report observed that:

Certain intangible assets identified are closely related to and associated with the real property of each subject resort. The subject resorts are unique, single location resorts and are considered “one-of-a-kind” in terms of their marketplace recognition. . . While the Franchise Rights/Brand could be extended to other locations, the fact is that the values associated with these intangible assets are tied to the real property for which they are intrinsically linked.

Taxpayer represents that: (i) the “goodwill” portion of the real estate intangibles relates to the location and physical structure of the Properties; (ii) the value attributable to the hotel name portion of the real estate intangibles relates to the uniqueness in history and heritage that the Properties represent to the marketplace; (iii) the real estate intangibles are inextricably and compulsorily tied to the real estate portion of the Properties; and, (iv) if Taxpayer’s acquisition had been a taxable asset acquisition rather than a stock acquisition, the “goodwill” and the value ascribed to the hotel names would have been included in the tax basis of the land and buildings for federal income tax purposes, and would not have been separately amortizable.

Prior to Year 3, Taxpayer had approximately e dollars in total assets with a portfolio of more than f properties. In Year 3, Taxpayer’s balance sheet changed dramatically after it sold over g properties to a third party. The Properties were the

principal assets of Taxpayer immediately prior to its acquisition by Corporation. The reduction in the number of properties in Taxpayer's portfolio caused a substantial decrease in Taxpayer's real estate assets. As a result, Year 3 marks a material change in the effect of the real estate intangibles on the tests under section 856(c) and necessitates this ruling request.

Law and Analysis:

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from certain enumerated sources, including "rents from real property", as provided in section 856(d).

Section 856(c)(4)(A) provides that at the close of each quarter of its tax year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities.

Section 856(c)(5)(B) defines the term "real estate assets," in part, to mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs. Section 856(c)(5)(C) provides that the terms "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon, but does not include mineral, oil or gas royalty interests.

Section 1.856-2(d)(3) of the Income Tax Regulations provides that in determining the investment status of a REIT, the term "total assets" means the gross assets of the REIT determined in accordance with generally accepted accounting principles (GAAP).

Section 1.856-3(b) provides, in part, that the term "real estate assets" means real property. Section 1.856-3(c) provides that "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon.

Section 1.856-3(d) provides that "real property" includes land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures). Local law definitions will not be controlling for purposes of determining the meaning of "real property" for purposes of section 856 and the regulations thereunder. Under this regulation, "real property" includes, for example, the wiring in a building, plumbing systems, central heating or central air-conditioning machinery, pipes or ducts, elevators or escalators installed in a building, or other items which are structural components of a building or other permanent structure. The term does not include assets accessory to

the operation of a business, such as machinery, printing press, transportation equipment which is not a structural component of the building, office equipment, refrigerators, individual air-conditioning units, grocery counters, furnishings of a motel, hotel, or office building, etc. even though such items may be termed fixtures under local law.

Although the definitions and examples of “real property” and “interest in real property” provided in the regulations are not exclusive, the plain language of those regulations leads to the conclusion that any asset other than the physical real estate itself must be inextricably tied or connected to the real estate to fall within either of those definitions. In the present case, the existence of the real estate intangibles is a function of a GAAP rule that provides that in business combinations such as this stock acquisition, the allocation of value to assets in excess of replacement cost must be attributed to goodwill or another intangible asset.

Each of Properties A-F was valued in excess of replacement cost. In each case, this “excess value” results to some extent from a physical attribute of the real estate such as the property’s architecture, beach location, or famous golf course. The name of each resort has little or no value independent of its relationship to the physical real estate attributes to which it relates. For example, naming a h a substantially similar name as Property C does not add extra value to the h because the physical real estate attributes for which Property C has become known do not exist with respect to the h. Therefore, notwithstanding its treatment as a separate asset for GAAP purposes, the renown and value of the brand or franchise name of each property is a function of and is integrally related to the conditions that produced the renown and value. In the present case, the value is primarily a result of the underlying real estate that makes the Properties unique.

Accordingly, to the extent that the value of the real estate intangibles is inextricably linked to the underlying real estate, the real estate intangibles will be treated as “real estate assets” under section 856(c)(5), for purposes of section 856(c)(4)(A) commencing with Year 3. Furthermore, to the extent that the real estate intangibles constitute real estate assets, any rent payments attributable to the real estate intangibles will be treated as “rents from real property” within the meaning of section 856(d).

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely yours,

William E. Coppersmith
William E. Coppersmith
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)